

Aquila Churchill Tax-Free Fund of Kentucky

Podcast Transcript July 25, 2018

Interviewer:

Today we're talking to Royden Durham, portfolio manager of Aquila Churchill Tax-Free Fund of Kentucky. At mid-year we typically see an increase in municipal bond maturities and calls. How would you describe the supply of municipal bonds currently, and what are you anticipating over the remainder of the year?

Royden Durham:

Kentucky rarely follows the heard and has issued 10 percent more bonds this year than last. Nationally, issuance is down almost 20 percent which falls in line with federal tax legislation to discontinue advance refundings, which made up almost the identical amount of issuance, 20 percent, of the market last year. Kentucky will see some called bonds in August, like Baptist Hospital and preponderance of calls and issuance comes earlier in the year, and typically in June. Our forward issuance schedule, which goes out 45 days, is as light as I've ever seen it, but I believe a \$200 million Baptist Hospital deal is in the offing. It does not currently show up on the calendar. Baptist recently bought Harden County Hospital, and there's a refunding opportunity on some issuance that was not called from their last deal which was about two years ago.

Interviewer:

Based on comments from the Federal Reserve it seems as though we can anticipate one or two additional increases in the Fed funds rate during 2018. How has the municipal bond market been trading, and where on the yield curve do you see value?

Royden Durham:

Right now, just a couple of days before a supposed big GDP number of over four percent is announced, we are expecting Fed moves of a quarter point in September and another in December. So, 50 basis points for the rest of the year. The trend of the curve has been flattening, but in the first quarter it steepened. I'm seemingly never with a herd of economists on predicting, and believe the curve will steepen while you hear others say it will go inverted. If we have higher growth, 4 percent plus, which is what they're anticipating, and inflation of over 2.4 percent, which we're very close to right now, how can it not steepen? Anyhow, the longer duration funds have still performed very well, but under my scenario that will be short-lived. I am happy with a four to five year effective maturity, but the value is where you would expect it in a rising rate environment out in the 20 to 30 year area. At this point I just can't be tempted to take that risk.

Interviewer:

We've continued to see positive economic indicators in the first half. Are municipal bond issuers seeing improvements in tax collections and other revenue sources?

Royden Durham:

Here in Kentucky, revenue increases have exceeded budget by 1.1 percent at the fiscal year end, which is June 30, 2018. Growth came mainly from increased income taxes, which mean more people working, and sales taxes which mean more people are confident about their economic circumstances. Combine this with the legislative tax increase for individuals, a flat 5% state income tax versus a graduated scale before, and taxes on 17 different services like lawn mowing, this revenue is projected to raise another \$500 million, and in a budget of \$10.5 billion, that's a lot of money. However, our major problems of underfunded pensions and Medicaid costs are still front and center. With the torrent of lawsuits, it's hard to imagine that those problems can be solved quickly or at all. I think that is now reflected in Kentucky's overall credit rating.

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Interviewer:

The Supreme Court recently determined that states could require retailers to collect sales taxes on internet transactions. Do you anticipate that sales tax receipts from this decision will be significant for the state?

Royden Durham:

This topic has not received much coverage in the local press when the Supreme Court made the decision. I think it was on June 22. One reason I believe is the way that Kentucky law is written with regard to taxing in-state businesses. So the large number of Amazon fulfillment centers here in the state, like in Shepherdsville, Kenton County, Campbellsville, and Jefferson County, are already collecting the 6% sales tax since Amazon, as the fulfillment processor of the order, must charge the tax. I'm really just going by my personal experience here, and feel like this revenue is already in the pipeline. I'll be paying close attention to press releases with regard to this topic, and hope my assessment is correct. With the huge growth in the sales tax in the last month of 2018 - the fiscal year ending June - of 8.8 percent, I think that gives credence to my theory. I've also read that Amazon is already collecting 50 percent of the sales taxes for 45 states. I'm sure Kentucky is one of them.

Interviewer:

Thank you very much. For those of you listening, before investing in the Fund carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund prospectus which is available on this site, from your financial advisor, and when you call 800-437-1020.

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